

# **Local Government Handbook: Legal Requirements – Contracts**

(revised 4/16/03)

## **Introduction**

Contracts are promises made between two or more parties that clearly state what each party expects of the other. Contracts are used to do many things. For example, contracts are often used to purchase goods and services; to sell services, to purchase and sell real estate; employ professionals, such as accountants and attorneys; and to enter agreements to define how responsibilities will be shared among different service providers, such as tribal and municipal memorandums of agreement.

Contracts are generally enforceable by the courts if the persons making the contract are:

- ✓ Legally competent;
- ✓ Have expressed their agreement in a definite manner;
- ✓ Have each made promises that are supported by payment equal to the goods or services received; and
- ✓ Have not agreed to do something that was impossible to perform at the time of the agreement, or that is illegal or violates public policy.

Contracts can be spoken agreements, but this is not a reliable method since spoken agreements can later be remembered differently by each party. The recommended method is to put all agreements in writing, signed by the persons who made the contract or by the persons authorized to sign for the organizations that made the contract.

## **Authority to enter into a contract**

In order to enter into a contract, the parties must have the authority to do so. Once a community is incorporated as a municipality it is considered competent and has the authority to enter into contracts.

### **Statutory Authority**

The statutory authority for municipalities to enter into intergovernmental agreements is conveyed by Alaska Statutes Title 29. AS 29.35.010 (13) conveys a general power to municipalities “to enter into an agreement, including an agreement for cooperative or joint administration of any function or power with a municipality, the state, or the United States.”

## **Elements of a Contract**

There are a few basic elements to most contracts. If any one of these elements is missing then the courts are likely to find that agreement was not reached and there is no contract. The basic elements of a contract are:

- Parties: The contract must state the persons or entities who agree to the contract;
- Promises: The contract must describe the promises or performance to be exchanged between the parties, generally goods or services;

- Consideration: The contract must state the consideration or payment given in exchange for the performances.
- Time for performance: The contract must also state a time when services will be performed or goods delivered and when payment is to be made.

## **Creating a Contract**

### **1. Determining Local Needs**

Before beginning contract discussions the following steps should be taken:

- Determine the purpose of the contract - what needs to happen, why is a contract being considered?
- List the basic terms to be included in the contract. Consult with other responsible parties or officials who will administer the contract to identify their needs, possible problems, and the duties of all parties as precisely as possible. Careful thought at this step can prevent possible problems in the future. Consult with an attorney at this point if the contract is not a simple agreement.

Check local ordinances or administrative procedures on contracts and other agreements to make sure the contract meets any local requirements.

After the purpose and terms have been identified, it is time to begin contract discussions, or negotiations, with the other party. Negotiations often begin with some discussion and agreement on the purpose of the contract and how to fulfill the purpose. One party then takes the lead and prepares a draft for review by the parties. If the agreement is a common one, such as a rental or a small purchase agreement, a standard contract form may serve the purpose.

### **2. Negotiating the Contract**

Each party to a contract wants something from the other party and both expect to be better off at the end of the contract than they were at the beginning. The basic purpose of the contract is to:

- Clearly state what each party expects,
- Identify any problems that may cause either party to be worse off at the end of the contract,
- Work out solutions to those problems in the contract, and
- Provide a way to deal with problems that the parties may not be aware of when the contract is made.

NOTE: If using a standard agreement form, know what it says. Do not copy standard agreements or terms unless they clearly apply and are clearly understood. Do not copy standard agreements or forms from this handbook unless you review them and determine they are appropriate.

Consult with an attorney if the agreement is complicated or if there is doubt about whether the terms and conditions in a standard form apply to the agreement being drafted. If an attorney has drafted parts of the agreement, make sure all parties understand them.

If the other party wants to change something, both parties then need to negotiate until all differences are worked out. If the parties cannot reach agreement, an attorney may suggest ways of writing the terms to satisfy both parties.

It is important to make sure that whoever will administer or carry out the agreement understands the terms. If questions come up, then the terms may need to be redrafted. Contact the other party and, if appropriate, the attorney that worked on the agreement to answer any questions. After the negotiations are done prepare the final version for formal approval and signature of the parties.

## **Contracts Frequently Used by Municipalities**

Municipal contracts or agreements can take many forms and cover a variety of goods, services, or activities. Following are some common examples:

### **1. Sales or Purchase Contracts**

A sales contract typically provides for the sale of goods in exchange for cash or time payments. The most common sales contract used by municipalities is a purchase order. A purchase order delivered to a vendor can be considered a contract between the issuer and the vendor.

Sales contracts often include the following provisions:

- **Description of goods purchased:** Describes goods to be purchased in enough detail to identify exactly what is being purchased. In some cases details such as the make, model, and serial number - might be needed.
- **Quantity:** States how much is being purchased.
- **Price:** States the price of the goods being purchased. Where appropriate, the price should state whether taxes and the cost of delivery are included in the price.
- **Time, place, and method of delivery:** States a time certain for delivery or a method for delivery and in some cases a delivery location. This may also state which party is responsible if the goods are lost or damaged in delivery.
- **Time and method of payment:** Describes when payment is expected and, in some cases, how payment will be made.
- **Warranty provisions:** Explains the manufacturer's or distributor's responsibilities to fix or replace the goods if they are damaged or not what was ordered and how the purchaser can enforce these warranties. Under the law most goods are assumed to be fit for the purposes for which they are sold unless there is a disclaimer in the contract that puts the buyer on notice that the goods may be defective. Disclaimers are often used, so it is important to know what these say and whether there is a significant risk to the purchaser. Typical disclaimer state that the goods are sold to the buyer "as, is, where is" or "with all faults."
- **Copyright limitations:** Computer software is a common item purchased by municipalities. Copyright limitations often prohibit copying the software and may limit the number of computers that can use the software.

### **2. Real Estate Contracts**

Municipalities frequently enter into written agreements to purchase, sell, or lease real property. Real property contracts can be used to:

- Transfer ownership of real property from one party to another (these are known as fee agreements);
- lease or rent only limited rights of for a certain length of time and, in some cases certain limited purposes;
- Grant easements, which transfer only the right for specific uses of property such as an agreement granting a telephone company the right to maintain a telephone line over a piece of property; or
- Permit limited use and occupancy of real property for a short period of time.

Real estate contracts are often used to acquire sites for the construction of municipal projects. Chapter three of DCED's *Capital Project Management Manual* provides helpful information acquiring a site.

NOTE: Municipalities must adopt an ordinance establishing a procedure for selling property (AS 29.35.090). Also, if a municipality is acquiring property and the acquisition is part of the cost of a capital improvement that will be financed from a bond issue, the bond may have to be approved by the voters before the purchase (AS 29.47.190).

Real estate contracts generally include the following provisions:

- **Property Description:** The legal description of the real property.
- **Property Interest Conveyed:** Describes the specific property interests, such as fee or leasehold interests, conveyed by the property owner and in a sale transaction whether the sale will be done by warranty deed or quitclaim deed.
- **Price:** Real property contracts identify the amount of money to be paid for the property or interest in property.
- **Maintenance:** Real property contracts should identify who will be responsible to maintain the property and who will pay any utility charges, taxes, or other charges against the property.
- **Title Insurance:** Some real estate contracts require one or both parties to provide title insurance that provides compensation to the buyer in the event that the title is not as described by the seller, such as an unidentified third party having a legal interest in the property.
- **Other Insurance:** Real estate contracts may require one party or the other to maintain adequate insurance throughout the contract period.
- **Closing Date or Term:** A real estate purchase contract will establish a date for the seller to deliver title papers and the buyer to deliver cash, generally called the closing. A lease contract or permit will provide a date for the lessee or permittee to take possession and a date when the contract will end.

### 3. Service Contracts

A service contract can be entered into for a variety of services. Examples of service contracts include road maintenance service contracts, professional service contracts made with consultants such as engineers and surveyors, contracts for temporary services provided during emergencies or performed on a seasonal basis, and construction contracts.

Service contracts frequently contain the following provisions:

- **Description of services:** Describes the specific services that are to be provided.
- **Description of individual providing services:** Service contracts may identify a certain person who will provide the service or may just identify a business.
- **Insurance and indemnification:** Service contracts may require the service provider to carry various forms of insurance including general liability insurance, worker's compensation insurance, and automobile liability insurance, or performance bonds. Service contracts typically require the service provider to, “defend, hold harmless, and indemnify,” the other party from claims, damages, or costs arising out of errors, omissions, or mistakes made by the service provider. (See *Local Government Handbook - Risk Management* for additional information on insurance and indemnification.)
- **Independent contractor:** A statement identifying the service provider as an independent contractor is often used to make it clear to the service provider that he or she is not an employee of the other party. As an independent contractor the service provider is generally responsible for carrying the appropriate insurance coverage, including worker's compensation, and is responsible for meeting all payroll tax and reporting requirements. It is important to know that such a statement in a contract does not protect a municipality from lawsuits when someone was reasonably led to believe that the service provider was an agent of the municipality. For this reason the insurance and indemnification clause is important.
- **Payment of fees:** Describes the contracting agency's responsibilities for payment for services and describes all conditions that must be met before payments are made.
- **Other compensation:** Service contracts usually contain a statement that limits the responsibility for payment to just the services and other expenses that are stated in the contract. For example, a contract between the city and an architect will state which party is responsible for paying the architect's travel expenses for the project.
- **Termination provisions:** A termination clause clearly identifies who has the right to terminate the contract and describes the allowable reasons for termination, how much notice must be given before termination, and the rights and duties of the parties in the event a contract is terminated before the end of the contract.

The Department of Community and Economic Development's *Capital Project Management Manual* [Chapters 5 and 6] contains useful information on drafting and negotiating a construction contract. A sample professional services contract is provided in the Appendix.

#### 4. Employment Contracts

Municipalities often use employment contracts when hiring for certain positions, such as a city manager or police chief.

An employment contract usually includes the following:

- ◆ **Date of hire:** The date employment begins.
- ◆ **Term of employment:** The date the employment ends if the parties do not renew the contract.
- ◆ **Rate of Pay and Benefits:** Pay and benefits the employee will receive.
- ◆ **Job Description:** A general description of the duties the employee is expected to perform. Often a more detailed job description is developed in addition to the brief description in the contract and is incorporated into the contract by reference..

- ◆ **Periodic Evaluations:** Timeframes for evaluation of employee performance, such as an interim and annual evaluations, are often included.
- ◆ **Termination:** An agreed to method for the employer or the employee to terminate the contract before the end of the contract is often included.
- ◆ **Renewal Process:** Describes how a contract will be renewed.

## 5. Intergovernmental Agreements

Contracting between government entities or other service providers for cooperative or joint administration may be done to provide administrative and other services such as water/sewer and electric utilities, public safety, etc. more cost effectively.

A contractual agreement, sometimes referred to as a Memorandum of Agreement, (MOA) is the method used to formalize joint/cooperative administration agreements. This contractual agreement is a legal document between the parties setting out the terms of the agreement and responsibilities of both parties. Issues such as who will be responsible for administration and/or operations and maintenance of services and/or programs identified in the contract are things that would be covered in the agreement. This type of agreement is usually entered into for one year with the option to renew at the end of the year.

Examples of intergovernmental agreements are contracts for administration of grant funds, cooperative agreements for providing services, and agreements to share resources. Intergovernmental agreements are often used between municipalities, a municipality and the IRA council, traditional council, or federal or state agency. The following are usually included in intergovernmental agreements:

- **Purpose and Intent:** This section clearly defines the reason(s) for the agreement. It may also provide a brief description of the background that lead up to the agreement.
- **Recognition of the Parties:** This section identifies the parties and briefly explains their roles and responsibilities within the agreement.
- **Duties and Responsibilities:** This section states the general cooperative management provisions of the agreement. For example, if the parties want to cooperatively manage a public facility, these provisions may address the responsibilities of each party for maintenance, operations, financing, administrative duties, liability, and other requirements of managing the facility.
- **Administrative Provisions:** This generally includes amendment procedures, obligations to spend funds, who assumes responsibilities for what, assigned risk, non-benefit clauses, the exchange of information, the effective date of the agreement, and signatures of authorized representatives.
- **Review Provision:** This section would provide a timeline for periodic review of the relationship to determine whether the cooperative arrangement is working out and whether the agreement should continue.

## Standard Contract Provisions

Examples of frequently used standard contract provisions in various municipal contracts are provided in the appendix of this handbook. The standard provisions show areas that should be addressed in different types of contracts; a municipality should use the standard contract language in

the appendix only if it clearly addresses the specific needs and purposes of the contract being drafted.

## **Enforcing the Contract**

A breach of contract occurs when one party stops performing or refuses to provide the goods, services, or other item required by the contract. When one party is in breach of contract the party who wants the contract to continue must take legal action to enforce the contract.

A person generally has three years from the date of the breach of the contract to sue for any damages that may have occurred (AS 09.10.053.) Under a special law, however, municipalities generally have six years to bring an action for a breach of a contract (AS 09.10.120.) In other words a municipality has six years from the date of breach to bring a legal action against the party causing the breach, but the other party only has three years from the date of the breach to bring an action against a municipality. This law is called a “statute of limitations”. It is a good idea to consult with an attorney about the particular contract that is being broken, since some contracts may have different limitation periods.

Going to court to force the other party to perform is called suing for specific performance. Rather than enforce the performance of the contract, courts may require one party to pay another for their damage (awarding damages). Damages are an award of cash to pay the party who has not breached the contract for any inconvenience caused by the breach. Once a breach has occurred it is advisable to contact an attorney, particularly if the contract is complicated or involves large sums of money.